Fiscal Note Revenue Impacts

The primary objective of the revenue impacts section is to allow legislators to make an intelligent, informed decision based on the best facts available in relation to revenue impacts associated with proposed legislation. The fiscal impacts should be written in a manner so that someone not familiar with the subject could come away with a full understanding of how the estimate was developed. Since most legislators will only take a moment to review each bill and may not be familiar with the subject, write as clearly and concisely as possible, avoiding the use of jargon and acronyms.

The fiscal impacts described within a fiscal note only concentrate on the direct revenue impacts of the legislation. The impacts should not try to assign a monetary value to the social benefits of a piece of legislation, or conduct extensive modeling to determine the secondary and tertiary economic impacts (also known as “dynamic” analysis). There is ample opportunity for legislators to debate these considerations in other venues.

Do not speculate beyond the language actually contained in the bill, or presume that the language in the bill will be corrected later: only project impacts on the current bill, regardless of forthcoming amendments. If there are technical problems with the bill, document the concern in the ‘Technical Concerns’ section of the fiscal note. Lastly, the fiscal impacts should always be factual and unbiased, irrespective of individual or agency viewpoints on the particular subject. Keep in mind that you and your agency’s credibility with the Legislature is affected by your ability to prepare objective, accurate, and factual fiscal notes.

Preparing Revenue Assumptions

- ✓ First, read the ENTIRE bill and not just the sections that affect your area of expertise. Identify the changes made by the legislation within the context of current statute, noting the citation references in Montana Code Annotated (MCA). Take care to consider sections of Montana Code that are repealed, as the *repealed sections will only be referenced on the title page*.

As the manual moves forward, the explanations of each section will include two separate examples of revenue impacts associated with two separate hypothetical bills. The first example, highlighted in blue, is a fiscal note for a bill that creates a property tax surtax that is levied upon property taxpayers who did not pay individual income taxes. The second example, highlighted in brown, is a fiscal note for a bill that would raise the class 8 property tax exemption from $5,000 to $50,000 (note that SB 48 passed by the 2005 Legislature actually did increase the exemption from $5,000 up to $20,000).

i. **The first assumption should always be a brief narrative on the proposed legislation that basically describes what the bill does, emphasizing the portions of the bill that create fiscal impacts. The bill description should also identify the changes from current law, noting the title and section of the MCA being changed. It is a good idea to also list sections of law that are repealed, what those sections currently say and do, and describe the impacts of repealing them. Don't be afraid to use multiple lines or assumption numbers to separate sections of the bill or topics.**

Example A:

ASSUMPTIONS:

1. This proposal provides that if the owner of a single-family residence has not paid Montana individual income taxes in the prior year, then the taxpayer will pay a percent surtax on the residential property tax for the current year to defray the provision of state emergency services to the property. (See technical note #1)
2. The proposal specifies a surtax equal to 20 percent of residential property taxes paid for tax year 2006, then beginning in tax year 2007 (FY 2008) the surtax escalates to 40 percent. (See Long-Range Impacts section)
3. All proceeds from the surtax are deposited in the state general fund.
4. Specifically, the bill provides that the surtax applies if the owner of the property "has not paid income taxes under 15-30-103, MCA, in the prior year". For the purposes of the revenue impact shown on this fiscal note, this is assumed to mean that the property owner is subject to the 20 (or 40) percent surtax if the taxpayer had no positive income tax liability for the tax year. All people who own a residence in Montana and pay residential property taxes, but who have no individual income tax liability for the prior year would be subject to the surtax, regardless of whether an income tax return was filed or not. (See technical notes #2 and #6)
5. Taxpayers who did not pay individual income taxes in the prior year because of age, infirmity, or misfortune are exempt from paying the surtax. (See technical note #5)
6. The bill also repeals section 15-6-219 (4), MCA, which specifically exempts bicycles from paying property taxes under Title 15. Since bicycles are also exempt under current sections 15-6-219 (5) (a) and under motor vehicle laws (61-3-321), repealing this duplicative section has no fiscal impact and is intended as cleanup language only.

Notice that technical concerns and other sections of the fiscal note are referenced within the assumptions.

Example B:

ASSUMPTIONS:

X1. The proposal would raise the threshold amount of class 8 property that an entity may own and be exempt from property taxation.

X2. Under current law 15-6-219, MCA, the exemption amount is $5,000 for class 8 personal property. The current law exemption amount is a statewide aggregate total amount of class 8 property owned by an individual or business entity.

X3. Effective for tax year (calendar) 2006, the proposal would raise the statewide aggregate exemption amount to $50,000.

ii. **Following the bill description, always include an effective date and list the fiscal years that will have revenue impacts. If applicable include a brief explanation of timing impacts, such as any necessary adjustments attributable to tax year (or calendar year) impacts adjusted to fit fiscal year revenues. If multiple sections of the bill have timing changes in relation to revenue impacts, the timing impacts can also be described throughout the assumption sections. Note that if there is no effective date listed on the proposal, that effective date is the following October 1st.**

Example A:

7. This proposal applies to property tax years beginning after December 31, 2005. This is assumed to mean that property tax bills will be subject to the surtax in tax year 2006 if the taxpayer did not pay income taxes in tax year 2005. Tax bills for tax year 2006 are paid in November of 2006 and May of 2007, so the earliest that this proposal will impact the general fund is FY 2007.

If a bill requires a fiscal year to tax year (or calendar year) adjustment for the analysis, this would be a good place for the explanation of the adjustment. Our second example illustrates:

Example B:

X4. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not-liened to real property pay property taxes 30-days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay sometime before April in the current fiscal year. Therefore, there are some FY 2006 impacts associated with the bill.

X5. About 38% of personal property is identified as “personal property not liened to real property”. Revenue collections from property taxes on personal property are calculated on the basis of 38% current fiscal year (FY 2006), to 62% following fiscal year (FY 2007).

iii. The computation and methodology portion of the analysis should be a step by step procedural explanation of how you arrived at the fiscal impacts. If possible, always show each calculation, even if it seems obvious. Distinguish between one-time and ongoing costs. Anticipate future revenue changes whether they are escalating or declining, but <u>ALWAYS include projected growth or declines in your analysis</u>. Growth and decline of current revenues should use the most recent HJR 2 projections. HJR 2 projections can be located in the Legislative Budget Analysis books available from the Legislative Fiscal Division. Project revenue for each separate state fund: general fund, state special revenue, etc.

Validate all information sources; make sure the material is from current, credible, and appropriate sources. In the assumption section, use annotations to document your sources of information, especially if it is from an outside source like the University system, national associations, research articles, or web sites.

<u>Example A:</u>

8. In tax year 2003 residential property taxes totaled $402 million. According to records from the individual income tax database, approximately $260 million of the total $402 million was taken as an itemized deduction on individual income tax returns where some individual income tax was paid.
9. An additional $24 million was paid by elderly taxpayers who also filed for the elderly homeowner/renter credit. These property taxes would not be subject to the surtax, leaving a balance of $118 million ($402m - $260m - $24m).
10. Of the aforementioned $118 million, surtaxes would not be payable for 1) taxpayers who are not residents of the state, but paid some state income tax on income attributable to Montana; 2) taxpayers who paid income taxes and own residential property but took the standard deduction, rather than itemizing deductions; and 3) taxpayers who own single-family residences but who rent those properties to other taxpayers. It is assumed that these taxpayers account for an additional $18 million in property taxes that would not be subject to the surtax. This leaves a balance of about $100 million ($118m - $18m) in property taxes associated with taxpayers who paid no individual income tax in the prior year.
11. Residential property taxes are expected to increase annually by 4.0% (JHR 2). Assuming that the property taxes associated with taxpayers who paid no individual income tax is growing at the same 4.0% rate as other residential property taxes, the tax base in (tax year 2006) fiscal year 2007 is estimated to be $ 112.486 million ($100m x 104.0% ^ 3 years).
12. Based on the above assumptions, it is estimated that this bill would raise approximately $22.5 million in FY 2007 ($112.486 million x 20% surtax = $22.5 million).

Example B:

X6. Under current law, there were 29,796 business entities or individuals that were subject to class 8 property tax in tax year 2004. The combined taxable value of their property in tax year 2004 was $117,240,984.

X7. Under the proposal, in tax year 2004, 20,762 additional business entities or individuals would have been exempt from class 8 taxes. The total taxable value of the property owned by this group of taxpayers in tax year 2004 was $11,457,536.

X8. Class 8 value statewide is expected to increase by 3.9% in tax year 2005 and 2.9% in tax year 2006 and succeeding years (HJR 2). For purposes of this fiscal note, it is assumed that the property in the aforementioned group with an aggregate value below $50,000 will also grow by the estimated average statewide growth rates of 3.9% in tax year 2005, and 2.9% in tax year 2006.

X9. Per assumption #X7 and #X8, the total taxable value of the property owned by owners with an aggregate of $50,000 or less is estimated at $11,904,380 ($11,457,536 x 103.9%) in tax year 2005, and $12,249,607 ($11,904,380 x 102.9%) in tax year 2006.

X10. Approximately 38% of personal property is identified as "personal property not liened to real property". Property taxes on personal property are calculated on the basis of 38% current fiscal year (FY 2006), to 62% following fiscal year (FY 2007).

X11. In FY 2006, estimated taxable value loss associated with this property is $4,523,664 ($11,904,380 x 38%). In FY 2007, the taxable value loss is estimated at $12,384,598 (($12,249,607 x 62%) + ($12,249,607 x growth of 2.9% x 38% for not liened to real property)).

X12. The average mill levy for the state general fund is 95.53 mills (95 mills plus the 1.5 mills levied in five counties for vo-techs).

X13. It is estimated that property tax revenue for the state general fund would decrease by $432,146 ($4,523,664 x 95.53 mills) in FY 2006, and $1,183,101($12,384,598 x 95.53 mills) in FY 2007.

X14. The mill levy for the university system is 6.00 mills.

X15. It is estimated that the university 6 mill account would be reduced by $27,142 ($4,523,664 x 6 mills) in FY 2006, and $74,308 ($12,384,598 x 6 mills) in FY 2007.

Notice that in both examples that each value is predicated by a previous figure from a prior assumption, and the reader can start from the first assumption and work their way down to a bottom line figure. It is very important that the computations do not include phantom figures as they will not only confuse the general public and legislatures, but also Budget Office personnel who must fully understand how the fiscal impacts were calculated.

iv. Effect on county or other local revenues or expenditures. If the proposal affects a local government entity, a fiscal analysis for local governments needs to be completed in the same manner as state impacts. However, if the underlying assumptions are the same for the local government and the state, the state impacts can be referred to without repeating all the steps.

Example A:

1) No local government Impacts.

Example B:

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

X1a. This bill would significantly impact local governments and school districts due to the loss in taxable value of $4,523,664 in FY 2006, and $12,384,598 in FY 2007. (See assumption #X11 under state fiscal analysis section)

X1b. The statewide average mill levy for this property in tax year 2004 (FY 2005) is 505.79. Statewide mill levies have increased annually by 4.5% since FY 2001. Assuming growth of 4.5%, the statewide average mill levy would be 528.55 (505.79 x 104.5%) in FY 2006, and 552.34 (528.55 x 104.5%) in FY 2007.

X1c. Removing the states 101.53 (95.53 + 6) mills, local governments and schools would have an estimated average statewide mill levy of 427.02 (528.55 – 101.53) in FY 2006, and 450.81 (552.34 – 101.53) in FY 2007.

X1d. The associated revenue decrease to local governments and school districts under the proposal is estimated to be $1,931,695 ($4,523,664 x 427.02) in FY 2006, and $5,583,101 ($12,384,598 x 450.81) in FY 2007.

X2). Under 15-10-420, MCA, county and city governments could float their mill levies to offset this property tax revenue loss. Since the amount of loss associated with this bill is significant, mill increases could be large; this would shift the impacts onto other taxpayers, particularly homeowners.

Along with revenue impacts, this section should indicate if there are new or expanded local mandates involved in the proposed legislation and the source of funding. Section 1-2-112, MCA, restricts state government (and new proposals) from mandating local government entities to perform an activity or provide a service or facility that requires the direct expenditure of additional funds *without* specific means of financing provided by the legislature from state or federal funds. This is an important statute to means test each new proposal against. If a proposal does mandate unfunded local government services, the fiscal note needs to address the issue. The following excerpts are from various fiscal notes where the bill conflicted with 1-2-112, MCA:

- The proposal assigns additional duties to the local government staff, specifically treasurers without any additional funding. This could be in violation of 1-2-112, MCA, which requires additional finances to local governments if they are required to perform duties outside the normal scope.
- If the costs are substantial, the proposal could be in violation of 1-2-112, MCA (unfunded mandate). Section 4(a) of that law considers an insubstantial amount to be “a required expenditure of the equivalent of approximately 0.1 mill or less levied on

taxable property of the local government unit". For a county with a tax base of $30,000,000, a 0.1 mill levy would produce $3,000. Of the 56 counties only 10 have a tax base greater than $30,000,000.

- When considering the comprehensive costs of an electorate vote, any costs greater than $194,203 which are distributed to the counties must be funded by the Legislature (1-2-112, MCA).

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v. Long-range impacts. Try to anticipate expenses for future years - address future spending outside the current biennium. At times, costs will be minimal the first or second year, but will accelerate in future years. If the long-term impacts of a bill are significantly different than they will be in the current biennium, those impacts should be discussed and quantified with the best information available. Questions to ask:

- **Are the costs or revenue changes back-loaded? Meaning the impacts are more significant in the long-term than the short-term.**
- **Are there escalating or decreasing revenues, expenses, or items that are exceptionally susceptible to changes in tax law or the economy (inflation, deflation, growth, enrollment, etc.)?**
- **Will the long-term impacts affect other areas of taxation, government, or the economy? If so, these should at least be noted as possibilities.**

The depth of the analysis will depend on the significance between the current biennial impacts and the long-range impacts.

Example A:

LONG-RANGE IMPACTS:

1. Section 3 of the proposal specifies that the surtax increases from 20 percent to 40 percent of residential property taxes paid beginning in tax year 2007, or fiscal year 2008.
2. Based on the prior assumption #7 through #10, assuming that the tax base remains proportional, and that the property taxes associated with taxpayers who paid no individual income tax continues to grow at the same 4.0% into the future, the tax base in (tax year 2007) fiscal year 2008 is estimated to be $ 117.0 million ($100m x 104.0% ^ 4 years).
3. In fiscal year 2008 and beyond, it is estimated that the bill will generate on the order of $47 million annually into the future ($117.0 million x 40% surtax = $47 million).

Example B:

LONG-RANGE IMPACTS:

The proposal will continue to reduce general fund revenues by approximately $1.2 million each year into the future.

vi. **Technical Notes or Concerns. The fiscal note may comment on mechanical or technical defects of the bill, but comments or opinions relative to the bill's merits are not appropriate. Technical notes should be included under the following situations:**
   - **Language in bill conflicts with other statutes, or does not change/update other statutes necessary for law to change.**
   - **Language in bill incorrectly references statute or term.**
   - **Language in bill is unconstitutional or is similar to language that has been ruled unconstitutional in the past.**
   - **Language in bill is unclear, or could be written more straightforward.**
   - **Bill does not address all issues (I.E. no definition of obligatory term or specifics on what is meant by a variable in a calculation)**
   - **Administrative problems or impossibilities exist in the proposal.**

Example A:

Technical Notes:

1. The surtax is 20 (or 40) percent of the property taxes payable. It is unclear what the surtax would be based and levied upon. It is unclear whether the surtax would be levied upon:
   a. only the state mill levies (95 mills for school equalization and the university 6 mill);
   b. all property taxes based on mill levies including local government and school mills; or
   c. in addition to all property taxes based on mill levies, would the surtax be levied upon property related fees like special interest districts (SID's) fees (street maintenance, fire hydrant, lighting, garbage, weed, water, sewer districts, etc.)?
2. American Indians living on reservation fee lands pay property taxes, but may not be required to pay individual income taxes by state or federal law. This bill would add a 20 (or 40) percent surtax to the property taxes of certain American Indians because they did not pay income taxes in the prior year, even though they may have had no legal obligation to pay income taxes. Language could be added to the bill providing that property taxpayers who for whatever reason are not subject by law to state individual income taxes would not be subject to the property tax surtax.
3. There are thousands of farmsteads organized as sole proprietorships, partnerships or other forms of pass through entities that are subject to individual income taxes. Generally speaking, current accounting practices and rules may result in many of these farms not paying individual income taxes. The property taxes on the residential portion of these farmsteads would be subject to the 20 (or 40) percent property tax surtax in each year following a year in which the farm operation showed a net loss.
4. In order to provide for the effective administration of this proposal, particularly with respect to ensuring compliance with the specific provisions of this bill, the Department of Revenue must have the capability of cross-matching individual income tax returns with property tax records. Currently, no such ability exists. Given the current state of database development, there is no way of determining if a particular owner of residential property did or did not pay individual income taxes in the previous year. Enforcement of this proposal would be extremely difficult; particularly in cases where the residential property is owned by a sole proprietorship or some form of pass-through entity for which the residential property taxes are taken as a business

expense deduction, rather than reported as an itemized deduction on the individual taxpayer's return.

5. The bill provides that taxpayers are exempt from the surtax because of "age, infirmity, or misfortune", but does not define what these terms mean. Providing a more precise definition would greatly facilitate administration of the provisions of this bill.
6. The bill provides that the surtax applies to taxpayers who have not "paid income taxes under 15-30-103 in the prior year." If a taxpayer files an income tax return for the prior year, and calculates his liability as zero, this may be construed to mean that the taxpayer has "paid income taxes under 15-30-103." The intent should be clarified by specifying that the taxpayer is subject to the surtax if the taxpayer had no income tax liability in the prior year. Further, "paid income taxes in the prior year" is unclear. Tax liabilities for tax year 2005 are often not paid until tax year 2006 when the return is filed; when are the taxes "paid"? Also, a taxpayer could "pay" a nominal amount of tax, and then claim a refund in subsequent years to avoid the surtax. Tying the surtax to a determination of positive tax liability associated with a specific tax year would facilitate and clarify the intent of the bill.
7. In administering the provisions of this bill, it would be necessary to provide county treasurers with information indicating whether or not a particular piece of residential property had or had not paid individual income taxes. Under current statutes this information is confidential. The bill may have to amend 15-30-303, MCA, to allow this information to be divulged to county treasurers or others that may need the information in order to effectively administer the provisions of the bill.

Example B:
Technical Notes:
No technical notes.

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vii. Unknown or unquantifiable impacts. The fiscal note impacts may be unknown or not quantifiable. If this is the case, the fiscal note analysis should give an example of what the potential impacts (range) are or illustrate what a unit is worth even thought the number of units impacted is unknown.

Example:
ASSUMPTIONS:

1. Allows the governing body of a municipality to levy a tax to support the funding of a 4-year campus of the Montana University System located within its jurisdiction.
2. It is unknown at this time if the municipalities would levy additional mills, and the number of mills per the bill.
3. Revenues from these levies would be deposited in the state general fund and must be distributed to the campuses based on the Board of Regents approved budgets.
4. For information purposes, the table on the following page shows that for every one mill levied, approximately $348,000 of property tax revenue would be generated if all municipalities levied.

5. For the purposes of this fiscal note it is assumed that there will be no mills levied in FY 2006 or FY 2007. If any mills were levied, the general fund expenditure would equal the revenue and there would be no impact to the general fund balance.

City / Town Taxable Value and Tax on 1 Mill Levy
Tax Year 2004

City	Taxable Value		1 Mill Levy		Revenue From 1 Mill
Billings	$130,326,693	x	0.001	=	$130,327
Butte[1]	48,172,935	x	0.001	=	48,173
Dillon	4,075,561	x	0.001	=	$4,076
Great Falls	66,376,100	x	0.001	=	66,376
Havre	7,737,467	x	0.001	=	7,737
Missoula	91,318,579	x	0.001	=	91,319
Total	**$348,007,335**				**$348,007**

[1]Butte Silverbow is a consolidated city/county government.

Other Reminders and Hints to Writing a Successful Revenue Impact Analysis

- ✓ When completing the analysis, ask yourself if the numbers look reasonable or realistic. Double check all formulas and calculations by hand to see if everything adds up.

- ✓ If there are questions over legal interpretation of current law and proposed law, get an opinion from an agency attorney.

- ✓ The analysis should focus on the fiscal implications of only one bill, without consideration of other proposed legislation or speculation beyond the language actually contained in the bill.

- ✓ Document your assumptions and sources of information so the calculation and analysis can be replicated. Maintain the integrity of your data and the credibility of your sources. Using valid data, within appropriate guidelines, will make it easier to withstand pressure to change your information from bill sponsors, constituencies, and lobbyists. OBPP is the final author and ultimately responsible for the fiscal note, but you may be called upon to defend your analysis.